rules, if promulgated in final form, will not have a significant economic impact on a substantial number of small entities. SBA perceives no economic consequences of this amendment. It is merely an administrative revision of programmatic guidelines. In addition these regulations, if promulgated in final form, would not constitute major rules for the purpose of Executive Order 12291.

**List of Subjects in 13 CFR Part 108**

Small businesses, Loan programs, Section 503 Certified Development Company Program.

## PART 108—LOANS TO STATE AND LOCAL DEVELOPMENT COMPANIES

Pursuant to the authority contained in section 308(c) of the Small Business Investment Act of 1958 (SBI Act), 15 U.S.C. 687, it is proposed to revise the introductory text and paragraph (b) of § 108.503–1, Chapter I, Part 108 of Title 13, of the Code of Federal Regulations, as follows:

**§ 108.503–1 Eligibility requirements.**

SBA is authorized to guarantee the timely payment of all principal and interest as scheduled on any debenture issued by any qualified development company. The full faith and credit of the Untied States is pledged to the payments of all amounts so guaranteed. Such debentures (herein sometimes referred to as 503 debentures) will be issued within certain limits solely for the purpose of assisting identifiable small business concerns to finance plant acquisition, construction, conversion, or expansion, including the acquisition of land. Plant construction includes the acquisition and installation of machinery and equipment. For the purpose of this section, development companies qualified to participate in this program (herein sometimes referred to as "503 companies") shall be formally certified by SBA on the terms and conditions contained herein, consistent with the intent of Congress. To qualify, a development company must demonstrate to the satisfaction of SBA that it has:

(a) * * *

(b) *Membership.* The 503 company must be representative of the state, counties, county or city in which the company operates. Evidence of such representation shall include the following: (1) The 503 company must have at least 25 individual members or stockholders that are representative of its area of operation. No member or stockholder may own or control more than ten percent of the development company's stock or voting membership.

(2) The membership must include participation by each of the following four groups.

(i) Government: The appropriate level of government that reflects the 503 development company's area of operation. State 503 development companies must have state governmental representation; countywide or multi-county 503 development companies must have governmental representation that ensures that each county is represented; citywide 503 development companies must have representation from the local city government.

(ii) A Private Sector Lending Institution;

(iii) Community Organization;

(iv) Business Organization;

(3) The board of directors must contain representation from (b)(3(i)) and (ii) of this section.

(4) The 503 development company must demonstrate to the satisfaction of SBA the capability required by paragraph (a) of this section adequate to its area of operation.

(5) Any 503 development companies which do not meet the above requirements shall do so on or before one year from the effective date of this regulation.

* * * * *

**James C. Sanders,**

*Administrator.*

[FR Doc. 82–14019 Filed 5–21–82; 8:45 am]

BILLING CODE 8025–01–M

---

## DEPARTMENT OF TRANSPORTATION

### Federal Aviation Administration

### 14 CFR Part 71

**[Airspace Docket Number 82–ACE–03]**

### Alteration of Transition Area—Dodge City, Kansas

**AGENCY:** Federal Aviation Administration (FAA), DOT.

**ACTION:** Withdrawal of notice of proposed rulemaking.

**SUMMARY:** This action withdraws the proposal to amend the Dodge City, Kansas, transition area. The amendment was proposed so as to permit an additional instrument approach procedure resulting from the installation of a Non-Directional Radio Beacon (NDB). It inadvertently indicated that an NDB instrument approach procedure would be established. There are no current plans for installing an NDB. Therefore, Notice of Proposed Rulemaking Docket No. 82–ACE–03 is being withdrawn.

**EFFECTIVE DATE:** May 12, 1982.

**FOR FURTHER INFORMATION CONTACT:** Don A. Peterson, Airspace Specialist, Operations, Procedures and Airspace Branch, Air Traffic Division, ACE–532, FAA, Central Region, 601 East 12th Street, Kansas City, Missouri 64106, Telephone (816) 374–3408.

**SUPPLEMENTARY INFORMATION:** On March 11, 1982, the FAA proposed to amend Subpart G, § 71.181 of the Federal Aviation Regulations (14 CFR 71.181) by altering the transition area at Dodge City, Kansas. The proposal appeared in 47 FR 10592, 10593. The amendent would provide additional controlled airspace for aircraft executing a new instrument approach to the Dodge City, Kansas, Municipal Airport, utilizing the Dodge City Non-Directional Beacon (NDB) as a navigational aid. Subsequent to the issuance of the proposal, the FAA ascertained that there are no current plans for installing an NDB at Dodge City, thereby making this NPRM moot. Accordingly, it is being withdrawn. Since this withdrawal cancels a proposed rule, additional notice and public procedure hereon under 5 U.S.C. 553(b) is unnecessary and impracticable.

**The Withdrawal**

Accordingly, pursuant to the authority delegated to me by the Administrator, Notice of Proposed Rulemaking Docket No. 82–ACE–03 (47 FR 10592, 10593; March 11, 1982), is hereby withdrawn.

**List of Subjects in 14 CFR Part 71**

Aviation safety, Transition areas.

(Sec. 307(a) Federal Aviation Act of 1958, as amended (49 U.S.C. 1348); sec. 6(c) Department of Transportation Act (49 U.S.C. 1655(c)); sec. 11.69 of the Federal Aviation Regulations (14 CFR 11.69))

**Note.**—This withdrawal cancels a proposal which is no longer applicable. For this reason, the FAA has determined that it involves a withdrawal of a proposed regulation which is (1) not a "major rule" under Executive Order 12291; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) it is certified under the criteria of the Regulatory Flexibility Act that the withdrawal will not have a significant economic impact on a substantial number of small entities.

Issued in Kansas City, Missouri, on May 12, 1982.

**John E. Shaw,**

*Acting Director, Central Region.*

[FR Doc. 82–13688 Filed 5–21–82; 8:45 am]

BILLING CODE 4910–13–M

**14 CFR Part 71**

**[Airspace Docket No. 82-ASW-26]**

## Proposed Designation of Transition Area: Waller, TX

**AGENCY:** Federal Aviation Administration (FAA), DOT.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Federal Aviation Administration proposes designation of a transition area at Waller, TX. The intended effect of the proposed action is to provide controlled airspace for aircraft executing a new instrument approach procedure to the Skylake Airport, Waller, TX. This action is necessary to provide protection for aircraft executing an instrument approach procedure using the Navasota VORTAC.

**DATE:** Comments must be received on or before June 23, 1982.

**ADDRESSES:** Send comments on the proposal in triplicate to: Chief, Airspace and Procedures Branch, Air Traffic Division, Southwest Region, Federal Aviation Administration, P.O. Box 1689, Fort Worth, TX 76101.

The official docket may be examined in the Rules Docket, weekdays, except Federal holidays, between 8 a.m. and 4:30 p.m. The FAA Rules Docket is located in the Office of the Regional Counsel, Southwest Region, Federal Aviation Administration, 4400 Blue Mound Road, Fort Worth, TX.

**FOR FURTHER INFORMATION CONTACT:** James L. Owens, Airspace and Procedures Branch, ASW-536, Air Traffic Division, Southwest Region, Federal Aviation Administration, P.O. Box 1689, Fort Worth, TX 76101; telephone: (817) 624-4911, extension 302.

**SUPPLEMENTARY INFORMATION:**

### History

Federal Aviation Regulation Part 71, Subpart G, § 71.181 as republished in Advisory Circular AC 70-3 dated January 29, 1982, contains the description of transition areas designated to provide controlled airspace for the benefit of aircraft conducting instrument flight rules (IFR) activity. Designation of the transition area at Waller, TX, will necessitate an amendment to this subpart. This amendment will be required at Waller, TX, since there is a new IFR procedure to the Skylake Airport.

### Comments Invited

Interested persons are invited to participate in this proposed rulemaking by submitting such written data, views, or arguments as they may desire. Comments that provide the factual basis supporting the views and suggestions presented are particularly helpful in developing reasoned regulatory decisions on the proposals. (Comments are specifically invited on the overall regulatory, economic, environmental, and energy aspects of the proposals.) Communications should identify the airspace docket and be submitted in triplicate to the address listed above. Commenters wishing the FAA to acknowledge receipt of their comments on this notice must submit with those comments a self-addressed, stamped postcard on which the following statement is made: "Comments to Airspace Docket No. 82-ASW-26." The postcard will be date/time stamped and returned to the commenter. All communications received before the specified closing date for comments will be considered before taking action on the proposed rule. The proposals contained in this notice may be changed in the light of comments received. All comments submitted will be available for examination in the Rules Docket both before and after the closing date for comments. A report summarizing each substantive public contact with FAA personnel concerned with this rulemaking will be filed in the docket.

### Availability of NPRM

Any person may obtain a copy of this notice of proposed rulemaking (NPRM) by submitting a request to the Chief, Airspace and Procedures Branch, Air Traffic Division, Southwest Region, Federal Aviation Administration, P.O. Box 1689, Fort Worth, TX 76101, or by calling (817) 624-4911, extension 302. Communications must identify the notice number of this NPRM. Persons interested in being placed on a mailing list for future NPRM's should contact the office listed above.

### List of Subjects in 14 CFR Part 71

Aviation safety, Transition areas.

### The Proposed Amendment

Accordingly, pursuant to the authority delegated to me, the FAA proposes to amend § 71.181 of Part 71 of the Federal Aviation Regulations (14 CFR Part 71) as follows:

**Waller, TX, New**

That airspace extending upward from 700 feet above the surface within a 6.5-mile radius of Waller, TX, Skylake Airport (latitude 29°59'26" N., longitude 96°03'30" W.).

(Sec. 307(a), Federal Aviation Act of 1958 (49 U.S.C. 1348(a)); sec. 6(c), Department of Transportation Act (49 U.S.C. 1655(c)); and 14 CFR 11.61(c).)

Note.—The FAA has determined that this proposed regulation only involves an established body of technical regulations for which frequent and routine amendments are necessary to keep them operationally current. It, therefore—(1) is not a "major rule" under Executive Order 12291; (2) is not a "significant rule" under DOT Regulatory Policies and Procedures (44 FR 11034; February 26, 1979); and (3) does not warrant preparation of a regulatory evaluation as the anticipated impact is so minimal. Since this is a routine matter that will only affect air traffic procedures and air navigation, it is certified that this rule, when promulgated, will not have a significant economic impact on a substantial number of small entities under the criteria of the Regulatory Flexibility Act.

Issued in Fort Worth, TX, on May 12, 1982.

**F. E. Whitfield,**

*Acting Director, Southwest Region.*

[FR Doc. 82-13892 Filed 5-21-82; 8:45 am]

**BILLING CODE 4910-13-M**

---

## SECURITIES AND EXCHANGE COMMISSION

**17 CFR Part 240**

**[Release No. 34-18738; File No.S7-930]**

## Order Exposure Rules

**AGENCY:** Security and Exchange Commission.

**ACTION:** Proposed rules.

**SUMMARY:** The Commission is proposing for comment two alternative Commission rules providing for increased exposure of orders in certain securities. These rules are proposed in response to concerns potentially arising from the present ability of market makers or market centers to execute orders without providing other markets access to those orders. The proposed Commission rule would require market makers or market centers to expose customer orders in certain securities to other markets before executing them internally. The Commission is also specifically requesting comment on the need for such a rule.

**DATE:** Comments to be received by July 23, 1982.

**ADDRESSES:** All comments should be submitted in triplicate and addressed to George A. Fitzsimmons, Secretary Securities and Exchange Commission, 500 N. Capitol Street, Washington, D.C. 20549. (Comments which will be received after July 15, 1982 should be addressed to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, 450 5th Street, Washington, D.C. 20549). All comments should refer to File No. S7-930 and will be available for public inspection at the Commission's Public Reference Room,

1100 L Street, N.W., Washington, D.C. (after July 3, 1982, 450 5th Street, Washington, D.C.).

**FOR FURTHER INFORMATION CONTACT:** Michael J. Simon, (202) 272-2889, or Robert Colby (202) 272-2886, Division of Market Regulation, Securities and Exchange Commission, 500 N. Capitol Street, Washington, D.C. 20549 (after July 15, 1982, 450 5th Street, N.W., Washington, D.C.).

**SUPPLEMENTARY INFORMATION:** The Securities and Exchange Commission ("Commission") is proposing for comment two alternative Commission rules, Rules 11A-1[A] and [B] under the Securities Exchange Act of 1934 ("Act"), to address concerns potentially arising from the failure of market makers or market centers to expose their order flow. Proposed Rule 11A-1[A] is based on a rule proposal submitted by the New York Stock Exchange, Inc. ("NYSE") and would only apply to over-the-counter ("OTC") market makers. Proposed Rule 11A-1[B], which is based in general on principles developed by a committee of the Securities Industry Association, composed of representative segments of the securities industry, would require exchange and OTC market makers to expose customer orders to buying and selling interest of other markets before dealing with these orders as principal. The Commission is also soliciting comment on a third alternative of deferring Commission action on an anti-internalization measure for the present time.

## I. Introduction

In the Securities Acts Amendments of 1975,[1] Congress charged the Commission with facilitating the development of a national market system. While not specifically defining what that system should comprise, Congress set forth a number of goals and objectives to guide the development of a national market system. Among these objectives was the enhancement of fair competition among brokers and dealers, exchange markets, and markets other than exchange markets.[2] Consistent with the Congressional desire to enhance competition through the removal of unnecessary regulatory restrictions, Congress specifically instructed the Commission to examine exchange off-board trading restrictions, which prevent exchange member firms from effecting transactions in listed securities other than on an exchange, and to remove off-board trading restrictions that have anti-competitive effects not otherwise justified by the goals or pruposes of the Act.[3]

The Commission considered exchange off-board trading restrictions in several proceedings following adoption of the 1975 Amendments, and concluded that these off-board trading restrictions impose burdens on competition.[4] However, the Commission also recognized that elimination of off-board trading restrictions with respect to principal transactions involved potential risks of internalization[5] of retail order flow by member firms, which in turn raised market fragmentation and fiduciary concerns. Consequently, the Commission has proceeded with caution in addressing off-board principal restrictions.[6] However, after thorough consideration, including six days of public hearings, the Commission in June of 1980 adopted Rule 19c-3 under the Act, precluding the application of off-board principal restrictions with respect to certain securities newly-listed on an exchange.[7]

In adopting Rule 19c-3, the Commission concluded that, at least with respect to Rule 19c-3 securities, the benefits of preserving existing OTC market making in competition with exchange markets, combined with the experiential benefits to the Commission and the industry of observing actual concurrent trading of listed securities by exchange markets and OTC market makers, outweighed the potential risks that might result from removing exchange off-board principal restrictions. In deciding to take action with respect to these principal restrictions, the Commission fully considered internalization concerns identified by commentators, including the potential problems of overreaching of customers by OTC market makers,[8] the fragmentation of order flow among market centers,[9] and adverse competitive effects on exchange market makers and small broker-dealers.[10]

Although the Commission determined to proceed with the Rule 19c-3 experiment, it recognized the significance of the potential internalization concerns raised by commentators. In response, the Commission suggested in the Rule 19c-3 Adoption Release several means by which internalization could be addressed if problems developed in the future, including a rule requiring market makers to hold out agency retail orders to other buying and selling interest for a minimum period of time before executing against that order as principal.[11] In addition, an ongoing surveillance program was established by the Commission in conjunction with the National Association of Securities Dealers, Inc. ("NASD"), to monitor the effects of Rule 19c-3 on the markets, and to detect and take action with respect to any problems that might develop. The Commission also indicated, however, that some internalization type concerns are also present in the trading of listed securities on exchanges, because orders sent to an exchange market are not necessarily exposed to other markets even where there is a superior quotation displayed by another market.[12]

At the time Rule 19c-3 was adopted, the Commission exphasized the importance of developing an effective linkage between exchange trading floors and OTC markets in Rule 19c-3

---

[1] Pub. L. No. 94-29 (June 4, 1975), 89 Stat. 97, [1975] U.S. Code Cong. & Ad. News 97 ("1975 Amendments").)

[2] Section 11A(a)(1)(C)(ii) of the Act.

[3] Section 11A(c)(4)A of the Act.

[4] *See* Securities Exchange Act Release No. 11942 (December 19, 1975,) at 5-7, 4 FR 4507, 4509; Securities Exchange Act Release No. 13662 (June 23, 1977), at 36-38, 42 FR 33510, 33514 ("June Release").

[5] The Commission has defined the term "internalization" as referring to "the withholding of retail orders from other market centers, for the purpose of executing them in-house, as principal, without exposing those orders to buying and selling interest in those other market centers." *See* Securities Exchange Act Release No. 16388 (June 11, 1980) at 18, n. 31, 45 FR 41125, 41128, n. 31 ("Rule 19c-3 Adoption Release").

[6] For a more complete discussion of prior Commission action concerning off-board trading restrictions, *see* Securities Exchange Act Release No. 15769 (April 26, 1979), at 5-8, 44 FR 25688-89.

[7] Specifically, Rule 19c-3 precludes exchange off-board trading restrictions from applying to reported securities (*i.e.*, securities for which transaction reports are made available pursuant to an effective transaction reporting plan), which were listed on an exchange after April 28, 1979 (the date of the proposal of Rule 19c-3) or which were listed on April 26, 1979 by ceased to be traded on an exchange for any period of time thereafter ("Rule 19c-3 securities").

[8] "Overreaching" refers to broker-dealer firms taking advantage of their customers by executing retail transactions as principal at prices favorable to those customers than could have been obtained had those firms acted as agent. *See* June Release, *supra* Note 4, at 70-84, 42 FR at 33519-21.

[9] Commentators have argued that fragmentation of order flow among disparate market centers potentially might result in a deterioration of the depth, liquidity and continuity of the markets, and a decrease in pricing efficiency. *See* Rule 19c-3 Adoption Release, *supra* note 5, 45 FR at 41128.

[10] *Id.*

[11] Rule 19c-3 Adoption Release, *supra* note 5, 44 FR at 41129. In addition, several alternative rules, proposed in the context of the earlier Rule 19c-2 proceeding with respect to off-board trading restrictions, remain outstanding. *See* June Release, *supra* note 4, 42 FR at 3525.

[12] Rule 19c-3 Adoption Release, *supra* note 5, 45 FR at 41129. Although the ITS participants have adopted trade-through rules that limit the execution of trades at prices inferior to the displayed quotation of another market, *see* Securities Exchange Act Release No. 17704 (April 9, 1981), 46 FR 22520, it appears that orders initially directed to an exchange often are retained there as a result of the specialist's matching, for purpose of an individual order, the superior quotation of another market.

securities, in order to achieve a greater degree of order interaction between markets, enhance opportunities for best execution, and allow full and effective competition to develop exchange and OTC markets. As a result, the Commission directed the NASD and the exchange participants in the Intermarket Trading System ("ITS")[13] to renew their efforts to develop an automated linkage which would allow orders to be routed efficiently between OTC and exchange markets. The ensuing discussions between the NASD and the ITS participants over a number of months, however, did not result in agreement on implementation of linkage.

Accordingly, after providing the parties an extended opportunity to develop a linkage entirely on their own initiative, the Commission on April 21, 1981, issued an order ("linkage order") mandating the establishment of an automated interface between the ITS and the NASD's enhanced NASDAQ system (referred to as the Computer Assisted Executed System, or "CAES").[14] Although internalization concerns were once again raised by commentators in the context of the linkage order, the Commission, after thorough consideration, determined that the interface would not directly exacerbate internalization concerns as a structural matter.[15] While the Commission maintained that development of a means of addressing internalization concerns was not a prerequisite to an interface and thus should not be allowed to delay the interface's implementation, it noted with approval the willingness of members of the securities industry to attempt to address internalization concerns on their own initiative, and expressed support for the ongoing industry efforts to develop an equitable and efficient resolution of those concerns which would be acceptable to all market participants.[16]

The resulting industry discussions have taken a variety of forms,[17] including discussions sponsored by the Securities Industry Association ("SIA"). Under the auspices of the SIA, a special committee, composed of respresentatives of the OTC and exchange markets, including OTC market maker and exchange specialists, met to develop principles on which an acceptable anti-internalization rule could be based, if one were deemed necessary.[18] After a number of extensive meetings during February and March of this year, the SIA committee reached agreement on certain general principles which should govern any inter-market exposure, rule, should it be determined that such a rule is needed. As discussed below, these principles contemplate that customer orders in Rule 19c-3 securities should be publicly exposed to other market interest. The principles would be generally applicable to all market makers in these securities, whether OTC or on an exchange floor.

In addition, the NYSE has submitted to the Commission a proposed rule incorporating order exposure requirements generally consistent with the SIA committee principles, but applicable only to OTC market makers in Rule 19c-3 securities. In making this submission, the NYSE did not discount the SIA committee's conclusion that additional exposure of public orders on exchange floors as well as in the OTC market also might be desirable. However, the NYSE argued that, because of the conflict of interest inherent in an OTC market maker trading as principal with his customer, concerns raised by the removal of off-broad trading restrictions required more immediate attention.[19] Still, the NYSE did express support for continued industry discussions regarding an exposure rule applicable to all markets.

The Commission regards the development of the general principles by the SIA committee as a highly commendable demonstration of dedication and initiative on the part of the committee members individually and of the securities industry generally. The Commission believes that the principles constitute a step forward in the process of articulating practical methods of addressing generalized order exposure concerns. The Commission also believes that the NYSE's effort to articulate those principles in rule form, reflecting the NYSE's belief that concerns raised by OTC internalization are materially different from concerns raised by the lack of order exposure in exchange markets, provides an important and concrete proposal addressing one aspect of this issue and serves a useful function in focusing industry attention on the issue. Notwithstanding the fact that this progress falls short of full resolution, however, the SIA committee has indicated (in the Commission's view correctly) that, in enunciating its internalization principles, the committee has completed its initial role. The NYSE has argued that, because of the complexity of the issues and the differing interests of sectors of the industry, further progress in addressing internalization concerns requires the active participation of the Commission. In light of the current status of these internalization discussions, the Commission believes that a full public discussion of the SIA committee principles, the NYSE proposal, and the underlying issue of the feasibility of an internalization rule, taking into account its cost and effect on the trading market, can most effectively be conducted now in the context of a Commission rulemaking proceeding.[20]

Therefore, to encourage widespread consideration of these internalization proposals and to promote discussion and comment on the merits of various rule formulations derivable from the SIA

---

[13] The ITS is an intermarket communications system operated jointly by certain national securities exchanges, and authorized by the Commission, on a provisional basis, as a national market system facility pursuant to 11A(a)(3)(B) of the Act. The current participants in ITS are the NYSE, and the American, Boston, Cincinnati, Midwest, Pacific and Philadelphia Stock Exchanges. In addition, the NASD has become an ITS Participant as of May 17, 1982. *See* note 14, *infra*.

[14] *See* Securities Exchange Act Release No. 17744 (April 21, 1981) 46 FR 23856 ("Linkage Order Release"). The linkage order orginally set a target date of March 1, 1982, for implementation of the interface. However, because of technical delays and the inability of the NASD and ITS participants to agree on amendments to the plan governing the operation of the ITS ("ITS Plan") necessary to include the NASD in ITS, the Commission postponed the implementation date until May 1, 1982, *see* Securities Exchange Act Release No. 18537 (March 4, 1982), 47 FR 10682, and proposed its own amendments to the ITS Plan. *See* Securities Exchange Act Release No. 18536 (March 4, 1982), 47 FR 10658. In view of the parties' continued inability to agree on the requisite amendments, the Commission has adopted its own amendments to the ITS Plan, including the NASD in ITS but generally deferring other outstanding issues until the end of the interface's six month pilot phase, in order to ensure timely implementation of the interface. *See* Securities Exchange Act Release No. 18713 (May 6, 1982). In addition, the Commission modified the linkage order by deferring the implementation date until May 17, 1982, on order to provide the ITS participants time to implement the Plan Amendments. *See* Securities Exchange Act Release No. 18712 (May 6, 1982).

[15] *See* the Linkage Order Release, *supra* note 14, at 46 FR 23861.

[16] *Id.* at 23860.

[17] *See* the discussion of the internalization negotiations contained in Securities Exchange Act Release No. 18536 (March 4, 1982), 47 FR 10658.

[18] The committee expressly refrained from addressing the question whether an internalization rule was necessary at the present time.

[19] *See* Memorandum Re the Urgent Need For an Anti-Internalization Rule for the Rule 19c-3 Pilot, prepared by the firm of Schiff Hardin & Waite, Special Counsel to the NYSE, contained in Letter from William M. Batten, Chairman, NYSE, to the Commissioners, Securities and Exchange Commission, dated April 5, 1982, at 13 ("NYSE memo").

[20] The Commission cannot emphasize too strongly the absolute necessity of continuing leadership from the SIA committee and other industry participants in coordinating further discussions on development of an equitable and efficient order exposure rule. The momentum created during the past few months must be sustained by immediate recommencement of these industry deliberations.

committee principles, as well as the necessity of an anti-internalization measure at the present time, the Commission has determined to propose for public comment two Commission rules under the Act. The Commission wishes to emphasize that the proposal of these rule formulations for the purpose of soliciting public comment does not constitute a determination that an anti-internalization measure is necessitated by present conditions or by implementation of the interface between the ITS and OTC markets. Indeed, the Commission is specifically requesting comment on the alternative of deferring a decision on an internalization rule, pending further study and evaluation of the results of the Rule 19c-3 experiment. In proposing these alternatives, the Commission is seeking to focus attention on the application of the order exposure principles to the existing markets, in order to further public discussion of internalization questions and to obtain the benefit of industry experience in considering the relative desirability and feasibility of each of the alternative proposals noted above.

## II. Summary of Alternatives

The Commission is proposing and solicits comment on the following alternative responses to internalization concerns.

*A. Deferring Action on an Anti-internalization Measure.* Under this alternative, regulatory action with respect to internalization would not be taken until such time as action was warranted by some specific evidence of significant adverse effects resulting from internalization.

B. *NYSE Rule Proposal.* The NYSE rule proposal, designated proposed Rule 11A-1[A], would apply only to OTC market makers in Rule 19c-3 securities. Under the rule, prior to executing a customer order as principal, an OTC market maker would be required to "stop" (*i.e.*, guarantee the execution of) the customer order, improve his bid or offer (as the case may be) to match the proposed execution price of the customer order, and publicly offer a customer sell order or bid a customer buy order, at an eighth better than the proposed execution price. Alternatively, a market maker could route its customer orders to CAES, but only if the market maker's proprietary traders were unaware of the entry of the order in CAES, and the person handling the order were unaware of the firm's proprietary position. Crossing two or more agency orders in the OTC market would be prohibited, except in CAES.

C. *All Market Exposure Rule Proposal.* The second rule, based on the SIA committee principles, designated proposed Rule 11A-1[B], would apply the order exposure requirements of proposed Rule 11A-1[A] to all market makers in Rule 19c-3 securities, whether off-board or on an exchange floor. Like proposed Rule 11A-1[A], the rule would require all market makers to stop a customer order at the proposed price, and publicly to bid or offer (as the case may be) the order at an eighth better than that price, before executing the order as principal. However, in order to reduce potential adverse effects on market making incentives and market efficiency, the rule would not require market makers to display a principal quotation matching the proposed execution price. Furthermore, OTC agency crosses outside of CAES would be allowed in certain instances. Proposed Rule 11A-1[B] also would contain a CAES order export alternative identical to that of proposed Rule 11A-1[A].

## III. Discussion

*A. Deferring Action on Internalization.*

In adopting Rule 19c-3, the Commission recognized that increased opportunities for internalization of customer orders would be a collateral consequence of permitting member firms to compete as OTC marketing makers in listed securities. The Commission noted, however, that in addition to providing the benefit of OTC competition in newly listed securities, removal of off-board trading restrictions with respect to Rule 19c-3 securities would provide the Commission with a unique opportunity to evaluate the concerns relating to internalization in a limited context.[21] The Commission also emphasized that the operation of a linkage between the ITS and the OTC markets was essential to a proper assessment of the extent and potential effects of internalization in the context of fully competitive markets.[22] Therefore, the Commission concluded that, in the absence of some demonstrated adverse effects on the markets for Rule 19c-3 securities resulting from internalization by OTC market makers, it would be premature to consider a regulatory response to internalization.[23]

Commentators have raised two primary arguments in opposition to Commission action at the present time with respect to internalization. First, since the inception of Rule 19c-3 no harmful effects relating to internalization have been demonstrated as resulting from OTC trading of Rule 19c-3 securities, and consequently no anti-internalization rule is needed.[24] In this connection, the Commission notes that its surveillance of Rule 19c-3 markets has not revealed any significant negative impact on the quality of these markets resulting from OTC market making in Rule 19c-3 securities.[25] Furthermore, the instances of potential overreaching identified by the NASD's and the Commission's ongoing monitoring efforts have been negligible.[26] Given these conditions, one commentator has stated that adoption of an anti-internalization measure by the Commission, in advance of any demonstrated internalization problems, would constitute "the essence of overregulation."[27] Indeed, other commentators, including a participant in the SIA committee, have suggested that it would be premature to evaluate internalization concerns before an automated interface went into effect, because such an interface could significantly ameliorate potential internalization concerns.[28] In particular, commentators have argued that the existence of a competitive environment, in addition to existing market information systems, would help provide discipline against overreaching of customers by dealers.[29] Commentators emphasized that this competitive discipline was, of course, supplementary to the fiduciary responsibilities of best execution owed by a market maker to a

---

[21] *See* Rule 19c-3 Adoption Release, *supra* note 5, 45 FR at 41130.

[22] *See Id.* at 41127; *see also* Linkage Order Release, *supra* note 14, at 46 FR 23857.

[23] *See* Rule 19c-3 Adoption Release, *supra* note 5, 45 FR at 41129; Linkage Order Release, *supra* note 14, 46 FR at 23857.

[24] *See* Letter from Elliot Smith, Bache Halsey, Stuart Shields, Inc.; William G. Morton, Dean Witter Reynolds, Inc.; Sam Scott Miller, Paine, Webber Jackson & Curtis, Inc.; and Thomas Sullivan, Smith Barney, Harris Upham & Co. Inc., to John S. R. Shad, Chairman, Securities and Exchange Commission, dated March 16, 1982 ("March 16 Letter").

[25] Securities and Exchange Commission, *A Monitoring Report on the Operation and Effects of Rule 19c-3 under the Securities Exchange Act of 1934*, August, 1981 ("Monitoring Report").

[26] *See, e.g.*, Monitoring Report, *supra* note 25, at 35.

[27] *See* Letter from Jeremiah A. Mullins, Chairman, and Morton Weiss, President, National Security Traders Association, to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, dated, March 24, 1982, at 2 ("NSTA Letter").

[28] *See* Letter from H. C. Piper, President, and Kenneth J. Wessels, Senior Vice President, Piper, Jaffray, & Hopwood, to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, dated, March 31, 1982, ("Piper, Jaffray Letter") at 2; NSTA Letter, *supra* note 27, at 2.

[29] *See* March 16 Letter, *supra* note 24, at 2; *See also* Rule 19c-3 Adoption Release, *supra* note 5, at 41129.

customer.[30] Commentators also have argued that, because of the efficiencies involved, internalization of order flow can result in benefits to customers, and consequently an anti-internalization rule would constitute a new artificial restraint on market making to the detriment of the public.[31]

The second argument against an anti-internalization measure is that it would have a detrimental impact on OTC market making. Commentators have argued that an anti-internalization measure, and in particular an order exposure rule such as proposed Rule 11A–1[A] or [B], would make it both expensive and cumbersome for a firm to execute customer orders from its own account.[32] These commentators assert that by imposing order exposure requirements that impair the efficiency of in-house execution of customer orders, such a rule would seriously reduce the profitability of a firm functioning as a Rule 19c–3 market maker and thus reduce incentives to make competitive markets in Rule 19c–3 securities. In addition, because the bulk of the order flow in Rule 19c–3 securities continues to be routed to the primary exchange markets, OTC market makers have had little opportunity to attract order flow other than from their own retail customers.[33] Consequently, impeding efficient execution by member firms of retail customers orders could seriously affect their ability to continue their market making function, thus reducing the potential for OTC market maker competition with exchange markets, and curtailing the Commission's experiment with concurrent OTC and exchange market making.

On the other hand, several arguments have been advanced in favor of an anti-internalization measure involving order exposure requirements, on grounds distinct from the question of whether in internalization measure is necessary to eliminate potential overreaching by OTC market makers. In particular, it appears that the changes in the manner of market making inherent in the order exposure alternatives of proposed Rule 11A–1 [A] and [B], discussed in greater detail below, could result in significantly increased opportunities for competition for order flow between markets and market makers, and in improved executions for public customers' orders.

By requiring that customers' orders in Rule 19c–3 securities be publicly bid or offered through the Consolidated Quotation System [34] before execution as principal, the order exposure requirements of the two alternative rules would provide other markets with access through ITS to the internal order flow of an OTC market maker, and, in the case of proposed Rule 11A–1[B], an exchange. As a result, market makers would for the first time be able to compete aggressively for other markets' order flow, offering the possibility of the development of vigorous intermarket competition, with possible resultant benefits for the quality of the markets.

In addition, these order exposure requirements could benefit public customers by requiring affirmative efforts on behalf of customer orders, augmenting those owned pursuant to a firm's fiduciary best execution responsibility.[35] The practical effect of the order exposure rules, in combination with the ITS participant's trade-through rules, would be to require a firm, prior to executing a customer order as principal, actively to seek a better execution than that evidenced by existing quotations. Specifically, a firm would be required publicly to bid or offer the customer order at an eighth better than its proposed execution price, which must equal the best prevailing quotation to avoid a trade-through, in order to elicit any interest at that better price from other market centers.

With respect to the alternative of deferring action on an anti-internalization measure, the Commission solicits comments (1) on whether an anti-internalization measure is necessary at the present time, and (2) on the likely effects of an anti-internalization measure on the efficiency of the operation of OTC market makers, and their willingness to continue engaging in Rule 19c–3 market making subject to an anti-internalization measure. In addressing the need for an anti-internalization rule and the effects on market makers of such a rule, the Commission requests commentators to address whether an order exposure rule would further additional national market system objectives by enhancing pricing efficiency, increasing competition for order flow, and providing better executions for public customers.

### *B. Proposed Rules*

1. *Description of the NYSE Rule.* The NYSE's proposed rule, which is being proposed by the Commission for comment as Rule 11A–1[A], would impose certain restrictions on the manner in which OTC market makers in Rule 19c–3 securities deal as principal with customer orders.[36] Specifically, the broker-dealer would have to follow one of two alternative sets of procedures before dealing as principal.

First, the broker could expose the order to other market centers (the "order exposure" alternative) by: (i) "Stopping" the total number of shares of the order (*i.e.*, guaranteeing the execution of the order) at the intended execution price; [37] (ii) exposing the customer order at a price ⅛ better than the intended execution price for 60 seconds; and (iii) publishing a quotation at the stop price for his own account for 60 seconds, in a size equal to the customer order. After doing so, if the customer did not receive an execution at the superior price, the broker-dealer may execute the order as principal.[38] Rule 11A–1[A] would except the broker-dealer from the requirement that he expose the customer order at a price ⅛ better if his existing published quotation represents a customer order at that price and is maintained for 60 seconds.[39] Similarly, the broker-dealer would not have to publish a quotation for his own account at the stop price if

---

[30] *See* March 16 Letter, *supra* note 24, at 2; Piper, Jaffray Letter, *supra* note 28, at 1.

[31] *See* March 16 Letter, *supra* note 24, at 2.

[32] *See* March 16 Letter, supra note 24, at 2; *see also* Letter from Jerry Williams, Jerry Williams Inc., to John S. R. Shad, Chairman, Securities and Exchange Commission, dated April 14, 1982.

[33] *See* Monitoring Report, *supra* note 25, at 15–17.

[34] The Consolidated Quotation System collects quotations in reported securities from all participating market centers and makes these quotations available in the form of a single consolidated data stream. The System was approved on a permanent basis on January 22, 1980. *See* Securities Exchange Act Release No. 16518 (January 22, 1980), 45 FR 6521.

[35] *See* Rule 19c–3 Adoption Release, supra note 5, at 41130, n. 60; *see also* Securities Exchange Act Release No. 15671 (March 22, 1979), 44 FR 20360 63 at n. 30.

[36] "Customer" is defined in Section (d)(13) of the rule to include, generally, (i) any person other than a broker-dealer and (ii) any person from whom an order has been accepted for execution, but only with respect to orders so accepted.

[37] In order to avoid trading through other ITS markets (*i.e.*, trading at an inferior price than available in other ITS markets), the stop price would have to be at least as good as the best price then available in any participating ITS market.

[38] For example, assume a customer sends an order to sell 500 shares of XYZ, a 19c–3 security, and the broker-dealer's quotation is 19⅞ bid, 20¼ asked (both for 100 shares), with the inside ITS market being 20 bid, 20¼ asked. The broker-dealer would have to (i) stop the order at 20; (ii) offer the 500 shares for the customer at 20⅛ (⅛ above the stop); and (iii) bid for the 500 shares at 20 as principal (the intended execution price). After publishing those quotations for 60 seconds, the broker-dealer could buy the 500 shares as principal at 20.

[39] If the quotation is for a proprietary account, the broker-dealer would have to increase the size of the quotation by the size of the customer order.

he already has published such a quotation and maintains that quotation for at least 60 second after receipt of the order.[40]

The second alternative available to the broker-dealer would be to enter the order into CAES otherwise than directing the order to himself for execution. This alternative (the "order export" alternative) also would require the broker-dealer to put in place procedures which would preclude (i) persons at the broker-dealer's firm responsible for proprietary trading in that security from having any knowledge of the customer order prior to its entry into CAES; and (ii) having persons responsible for dealing with customer orders in that security from having any knowledge of the firm's proprietary positions or trading strategy in that security (the "knowledge limitation").

In addition, the rule would require that all agency cross transactions not executed on a national securities exchange would have to be entered into CAES. Finally, Rule 11A–1[A] would exclude from its "hold out" and "order export" requirement certain types of transactions, including block transactions,[41] tender offers, certain distributions and odd lots.[42]

2. *Description of the All Market Exposure Rule.* The SIA Special Committee on the ITS–NASD Market Linkage was comprised of representatives of integrated warehouses, regional broker-dealers, block and institutional broker-dealers and exchange specialists. Although the committee has not finished its work and has not propose a specific rule, it did develop a set of principles describing an order exposure rule to address internalization, if it is determined that an anti-internalization rule is necessary. The Commission has taken those principles and applied them generally to the NYSE rule in order to proposed an alternative rule for public comment. That rule, proposed as Rule 11A–1[B], while generally based on the SIA committee principles, also includes provisions contained in the NYSE rule as well as provisions not directly addressed by the committee, but which the Commission believes may make trading pursuant to the rule more efficient.

Rule 11A–1[B] reflects the SIA committee's agreement that any rule addressing internalization should apply both to OTC market makers and exchange specialists in Rule 19c–3 securities. The rule also reflects the SIA committee's agreement that a rule should contain an order exposure alternative similar to that contained in the NYSE rule. The SIA committee principles, and thus prposed Rule 11A–1[B], differ from the NYSE rule in that the order exposure alternative would require only that the customer's order be exposed at a better price than the existing quotation, and not that the dealer expose his principle interest in the order at the intended execution price. Rule 11A–1[B], however, like Rule 11A–1[A] would require a stop at the intended execution price.

Not addressed in the SIA principles is the procedure to follow when the dealer already has outstanding a quotation at a price ⅛ superior to the intended execution price. The Commission is proposing, as an alternative to the procedure suggested by the NYSE, that the market maker need not increase the size of that quotation as long as the size of the quotation is at least that of the customer order, even if the market maker's quotation is as principal. The customer order, however, would be "deemed" to be represented by the market maker's quotation for 60 seconds after receipt of the customer order. Thus, if during that 60 second period, the market maker's quotation is executed against, the Rule would require that the customer order receive the benefit of the execution.[43]

With respect to agency crosses, the SIA committee indicates that it has not completed its deliberations on the subject but is working on the concept of a general order exposure requirement. While the Commission encourages the SIA Committee to continue its efforts to develop a more detailed description of how they expect such a requirement to work, Rule 11A–1[B] would permit OTC market makers to execute agency crosses if (i) the inside ITS market has a spread greater than ⅛ and the cross is executed between those quotations, or (ii) the inside ITS market is a ⅛ spread and the cross is executed at either the bid or the offer.

With respect to the order export alternative, although such a specific alternative was not proposed by the SIA committee, the Commission believes that such an alternative may enhance efficient compliance with the Rule for brokerage firms with a large retail business. Therefore, the Commission has included an order export alternative in proposed Rule 11A–1[B]. The Commission also has included in Rule 11A–1[B] the exemptions proposed in the NYSE rule and the authority for the Commission to grant exemptions from the rule.

3. *Discussion.* There appear to be two general issues posed by the consideration of any specific rule to address concerns regarding the lack of order exposure. First, should the rule apply only to one market as the NSYE rule does, or should the rule apply to all markets in Rule 19c–3 securities as the all market exposure rule does?[44] Second, regardless of which markets are subject to the rule, what specific restrictions should be imposed on broker-dealers before they can deal as principal with customer orders?

With respect to the markets to be covered by the rule, in proposing an anti-internalization rule addressing only the OTC market in Rule 19c–3 securities, the NYSE argues that the problems presented by OTC internalization have no true counterparts in other types of markets, and that it is not helpful to equate the OTC market for Rule 19c–3 securities with exchange markets. Generally, the NYSE argues that, while exchange specialists can deal as principal, they must follow exchange auction rules and, among other things, expose customer orders on the floor of

---

[40] If a broker-dealer's proprietary quotation is accepted in whole or in part by one or more third parties, and the broker-dealer subsequently revises his quotation, superseding the quotation representing the customer order, the broker-dealer, is deemed to have met the hold out requirements and may execute the customer order at the stop price. For example, in the example in note 38, *supra*, if the broker-dealer's bid of 20 is accepted and the broker-dealer lowers his quotation to 19⅞ bid, 20 asked, the broker-dealer can execute the customer's 500 share sell order at 20.

[41] A block is defined in section (d)(17) of the rule to be 10,000 shares or a quantity of stock having a market value of $200,000 or more.

[42] The Commission has made a number of minor technical changes to the NYSE submission. These changes include exempting from the rule transactions outside normal business hours (exchange off-board trading restrictions do not apply at such time), adding definitions of "effective transaction reporting plan," "transaction report," "ITS," "CAES," "third market maker," and "broker-dealer" and giving the Commission the authority to grant exemptions from the rule.

[43] Rule 11A–1[B] also provides that, if the broker-dealer changes his quotation to the stop price during the 60 seconds that a customer's order is exposed either due to an execution at this quotation price or otherwise justified by market conditions, the broker-dealer will have satisfied his hold-out obligations and may execute his customer's order at the stop price. For example, if the broker-dealer has stopped his customer sell order at 20, and has a preexisting customer offer outstanding at 20⅛, which then is executed against in whole, the broker-dealer can lower his offer to 20, the stop price, and execute the customer's sell order at that price. Similarly, if the market moves down, and the broker-dealer wants to lower his principal offer to 20, the broker-dealer may do so if he executes the customer order at the stop price (20), even if the customer order had not been exposed for 60 seconds.

[44] In addition, the rule theoretically could apply to a designated subset of markets, such as the primary exchanges and the OTC market, but not the regional exchanges.

their respective exchanges before executing the order as principal. On the other hand, the NYSE argues that the OTC market consists of integrated broker-dealers who both make markets as principal and deal with their customer order flow on a fiduciary basis without an independent agent determining in which market the order should be executed, and without exhange-type auction trading protection.[45] This, the NYSE argues, requires special anti-internalization procedures to be imposed on the OTC market for Rule 19c–3 securities. The NYSE, however, does acknowledge that there are limitations on order exposure in other markets (although, according to the NYSE, long-standing and distinguishable) with respect to which corrective action may ultimately be desirable. Nevertheless, the NYSE does not believe that such limitations need be addressed concurrently with resolving concerns regarding OTC internalization in Rule 19c–3 securities.

The SIA committee, in contrast to the NYSE, reached the conclusion that any Commission rule should apply to all markets with respect to Rule 19c–3 securities, and not just the OTC market. Although not stated explicitly by the committee, it appears that the committee members concluded that, to the extent enhanced order exposure is a principal goal in this context, any rule should include exchange markets as well as the OTC market. While each exchange member does make an independent decision as to which market to send its customer orders, the Commission understands that the firm's decision is generally made by designating one market to which it sends all of its retail order flow. Because most brokerage firms do not route on an order by order basis to the best displayed quotation, once that firm has designated a market for receipt of its retail order flow in a particular security, in effect, the specialist in that market is in a competitive position comparable to an upstairs firm because no other market participant can successfully attract those orders from him.[46] These competitive similarities are greatest with respect to orders which are routed through the various exchange small order processing systems directly to the specialist, without an independent floor broker handling the order. The Commission also notes that expanding an order exposure rule to all markets would provide customer orders in all markets the opportunity to achieve a better execution through exposure to other market interest. In addition, such an all market rule might allow for increased pricing efficiency, and the exposure of all orders to trading interest in all markets potentially could lessen concerns about fragmentation of the markets.

The Commission specifically requests comment on these positions and arguments concerning which markets should be subject to an order exposure rule. In this regard, the Commission requests commentators to focus on the structural differences between the OTC and exchange markets and to assess how those differences affect implementation of the order exposure principle.

Finally in this regard, the Commission recognizes that those regional exchanges which have small order execution systems which price derivatively off the best ITS quotations (or certain exchange quotations) may have considerable difficulty adapting such systems to comply with either rule under consideration. Therefore, the Commission requests comment on the effects of a "hold out" requirement on regional exchanges and whether, if a rule were to be adopted for all markets, the regional exchanges should be given a certain amount of time to adapt their systems to comply with the rule, or whether any other type of relief may be appropriate.

The second general issue with respect to an order exposure rule to be addressed, is, regardless of which markets are covered by such a rule, what requirements should the rule impose on broker-dealers before they execute a customer's order as principal? In this regard, while the NYSE rule and the rule based on the SIA Committee principles have much in common, there are significant differences.

The Commission notes that while both rules contain a hold out alternative, the NYSE believes that, with respect to that alternative, it is necessary for OTC market makers not only to attempt to achieve an execution for the customer ⅛ better than the current quotation, but to expose his own intention to deal as principal at the stop price. The NYSE apparently believes that this is important to ensure that OTC market makers are publicly disseminating quotations representing the best price at which they are willing to trade. While this requirement does eliminate the possibility that OTC market makers could execute their customer orders in a "hidden market" without providing other market participants any access to that market, it also might increase market making risks by exposing OTC market makers to the risk of double executions each time they export a customer order.[47]

Rule 11A–1[B], on the other hand, requires exposure only of the customer order. While this requirement is easier to meet administratively, and eliminates the possibility of a double execution, it would not require dealers to expose directly their actual principal interest.

The Commission requests comment on which version of the hold out requirement is most appropriate. In particular, the Commission requests comment on whether the possible increased market access and competition that may result from the NYSE proposal outweigh the possible burden on market making efficiency and risk that may result from holding out principal, as well as customer, interest.

A second difference between the two hold out requirements concerns the procedures to follow when the dealer already is disseminating a bid (or, in the case of a customer buy order, an offer) as principal, at ⅛ better than the customer order, in a size at least as large as the customer order. While Rule 11A–1[A] would require that the customer order be "exposed" by increasing the size of the bid (offer) by the size of the customer order, Rule 11A–1[B] would exempt the dealer from

[45] The NYSE recognizes that the traditional OTC market for unlisted securities is, to an extent, a "sponsored" market, based somewhat on internalization. While the NYSE does not believe that this is a desirable model for exchange-listed stocks, the NYSE believes such a market is suitable (and perhaps necessary) with respect to the vast majority of stocks traded OTC, and does not believe an anti-internalization rule should be imposed with respect to unlisted stocks. The Commission also recognizes that order exposure techniques for Rule 19c–3 securities may not be readily transferable to the OTC market for unlisted securities and that such techniques could seriously disrupt the existing competitive dealer structure for trading the vast majority of OTC stocks. While the Commission encourages the OTC community to enhance the order routing and execution capabilities in its market, the Commission has no intention of mandating any internalization rule for the OTC market in unlisted stocks, because of the different competitive structure of that market.

[46] Of course, ITS enables competing market makers to attract some orders by the display of superior quotations. However, the specialist holding the order may avoid any obligation to send that order away by matching the best bid or offer (as the case may be) in ITS.

[47] For example, if a broker-dealer wished to execute a sell order at 50, he first would have to offer that order at 50⅛ and change his own bid to 50 for a minimum of 60 seconds. If, during that 60 seconds, his bid is hit and the customer's offer is not, the broker-dealer would be required to honor his stop, thus purchasing twice as much stock as he wished. If this example occurred while the market was moving downward, the broker-dealer might be exposed to a substantial risk of trading losses.

any further requirements.[48] In this regard, the Commission requests that commentators balance the benefits of all markets participants being informed of all customer interest[49] against the administrative burdens of increasing quotation size for 60 seconds.[50]

A final difference between the two order export requirements involves agency crosses. The NYSE rule would prohibit OTC agency crosses unless firms route such transactions through CAES. Rule 11A–1[B], on the other hand, would exempt agency crosses from any requirement as long as the orders are executed between the quotations, or, if the spread is ⅛ point, at either quotation. In proposing this exemption for agency crosses, the Commission notes that if the execution is between the quotations both customers are receiving a superior price than they might otherwise receive. Moreover, it may be somewhat anomalous to impose greater restrictions on upstairs execution of agency cross transactions because (i) those transactions may not raise the same conflict of interest concerns present with respect to principal transactions, and (ii) there would appear to be limited occasions in which a customer buy and sell order would arrive together at one firm. Agency cross transactions therefore would appear to have a more limited effect on competition between marketplaces than market maker principal transactions. Finally, the Commission notes that CAES currently does not have the ability to accept agency crosses as such, but requires each side of the cross to be entered separately. Accordingly, the Commission requests comment on these differing approaches to agency cross transactions, and, in addition, invites commentators to suggest alternative means to address this issue.[51]

The Commission also requests comment on those aspects of the two rules that contain the same requirements. For example, the Commission notes that both rules would prohibit OTC market making in Rule 19c–3 securities included in the automated interface otherwise than by ITS/CAES market makers. The Commission requests comments on whether this limitation is appropriate or whether all broker dealers should continue to be allowed to trade such securities OTC, with only those broker-dealers with access to the automated interface subject to the rule.

Both rules also provide exceptions for block transactions. The Commission preliminarily believes that this is appropriate and that concerns regarding block transactions can best be addressed through the current block application of the ITS trade-through rules and through the development of mechanisms to protect away-from-the-market orders from block executions at inferior prices. The Commission specifically requests comment on the appropriateness of the block exception.[52]

The Commission also requests comment on the desirability of providing an order export alternative. If it is believed that such an alternative is appropriate, the Commission requests comment on the advisability and practicability of including the "knowledge limitation" as part of that alternative. In this regard, the Commission interprets the knowledge limitation not to require the physical separation of a firm's proprietary and agency trading activity, but that a firm would meet this limitation if it had in place procedures which ensured that coordinated agency and principal orders would not be entered into CAES. The Commission requests comment, however, on whether actual physical separation is necessary in order to ensure that OTC market makers do not enjoy inappropriate competitive advantages with respect to their customers' orders.

The Commission also requests comment on the other common aspects of the two rules. Those areas include: (i) The effect and necessity of stopping the customer order at the intended execution price, although the market may move adversely to the broker-dealer during the time of the stop, and, in particular, whether such a requirement poses an inappropriate burden on competition if only imposed on OTC market markers; (ii) whether 60 seconds is an appropriate length of time (or too long or too short) to impose the stop and disseminate the quotations; (iii) the clerical difficulty of changing only one side of a quotation or quotation size on the current NASDAQ terminals;[53] and (iv) what effect the "stop" requirement would have on existing exchange rules in the area.[54]

Finally, the Commission requests comment on whether it would be appropriate to provide an exception from any rule for small orders of 200 shares or less (or any other size commentators may believe would be appropriate). In this regard, the Commission notes that in January 1982, orders for 200 shares or less accounted for 43.7% of the transactions executed on the NYSE, but only 5.1% of the share volume executed on that exchange. Therefore, the Commission requests commentators to balance the potential increased efficiency in handling small orders that may result from such an exception against the possible adverse effects on best execution, pricing efficiency and market making competition of removing such orders from the public market place.[55]

## IV. Conclusion

The Commission is requesting comment both on the need for a rule addressing internalization at the present time and, if a rule is believed necessary, on specific proposals based on industry submissions. The Commission has reached no conclusions regarding the need for such a rule or on the relative merits or shortcomings of the specific proposals. The Commission's action today should be viewed as an effort to stimulate the industry to continue their deliberations on this issue and to seek some accommodation, if not complete consensus, on an appropriate resolution of the matter for purposes of the rule 19c–3 experiment. The Commission and

---

[48] As discussed above, however, the customer's order would, in effect, be substituted for the dealer's quotation and the customer would receive the benefit of any execution at that price.

[49] The Commission notes, however, that in both rules, if the broker-dealer's bid or offer already is an agency order, the broker-dealer does not have to expose any other agency order of the same or lesser size.

[50] For a further discussion of this administrative difficulty in the OTC market, *see* note 53, *infra*.

[51] Other approaches to dealing with agency crosses include variations of the hold out approach. For example, a broker-dealer could be required to hold out both the buy and sell order (presumably not simultaneously to avoid a locked or crossed market. Alternatively, the broker-dealer could be required to hold out only one side of the order.

[52] The Commission understands that the SIA committee intends to continue its deliberations with respect to the need for imposing order exposure concepts on block transactions. The Commission encourages this further consideration and invites all other prospective commentators to address this issue.

[53] Current NASDAQ terminals allow for the relatively easy changing of both of a market maker's quotations in the same direction for the same number of shares. It is significantly more cumbersome, however, to make other types of quotation changes. The Commission also notes, however, that because proposed Rule 11A–1[B] does not require exposure of principal interest, or the adjusting of quotation size if there is an outstanding principal quotation at the appropriate price, and size, that rule often would require fewer adjustments of quotations.

[54] *See, e.g.*, NYSE Rule 116.

[55] The Commission also requests comment on whether there should be a *de minimis* exception for exchanges or market makers with a minimal level of activity in the subject Rule 19c–13 securities. *Cf.* Securities Exchange Act Release No. 18482 (February 11, 1982), 47 FR 7399 (providing an exception from Rule 11Ac1–1 for market centers with less than one percent of the quarterly aggregate trading volume in a Rule 19c–3 security).

its staff are fully committed in their support of the industry in this endeavor.

**V. Summary of the Initial Regulatory Flexibility Analysis**

The Commission has prepared an Initial Regulatory Flexibility Analysis (the "Analysis") in accordance with 5 U.S.C. 603 regarding proposed alternative Rules 11A–1[A] and 11A–1[B].

The Analysis notes that although the securities industry has made progress in developing an approach to addressing concerns related to the internalization of customer orders, the difficulty of the industry groups to reach a final consensus approach on all aspects of internalization necessitates that the Commission take an active role in this area. In this connection, the objective of this rulemaking is to present three specific approaches by which the Commission can address internalization concerns at this time, including two alternative order exposure rules, and an alternative which takes no regulatory action in the absence of demonstrable harm caused by internalization.

The Analysis notes that both of the proposed rules could potentially apply to all broker-dealers who make markets in 19c–3 securities which are eligible to be traded through the ITS/CAES interface.[56] The Analysis also notes that although both rules would impose certain administrative compliance costs on broker-dealers, and could increase their market making risks, each rule offers a broker-dealer the option of competing for its own order flow by exporting its customer orders to CAES. In this connection, the analysis notes that because of the relatively small numbers of customers orders handled by a small broker-dealer, the administrative burdens of this rule on those broker-dealers would appear small. Moreover, the analysis notes that both rules also provide all market makers new competitive opportunities by permitting them to access the customer orders exposed by other markets. The Commission is soliciting comment on the precise impact of each proposed alternative, and will utilize this information in seeking to adopt the approach which minimizes the burdens on broker-dealers while still effectively addressing valid internalization concerns.

A copy of the Analysis may be obtained by contacting William W. Uchimoto, (202) 272–2906, Division of Market Regulation, Securities and Exchange Commission, 500 North Capitol Street, NW., Washington, D.C. 20549 (after July 15, 1982, 450 5th Street, NW., Washington, D.C.).

[56] Proposed Rule 11A–1[B] also would apply to all national stock exchanges trading Rule 19c–3 security. The Commission notes, however, that no national stock exchange trading Rule 19c–3 security is defined as a small entity. *See* Rule 0–10(e) under the Act.

**List of Subjects in 17 CFR Part 240**

**Reporting requirements, Securities.**

**VI. Text of Proposed Rules**

## PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

The Securities and Exchange Commission hereby proposes to amend Part 240 of Title 17, Chapter of the Code of Federal Regulations, pursuant to its authority under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*, as amended by Pub. L. No. 94–29 (June 4, 1975)), particularly Sections 2, 3, 6, 9, 10, 11, 11A, 15, 15A, 17 and 23 thereof (15 U.S.C. 78b, 78c, 78f, 78i, 78j, 78k, 78K–1, 78*o*, 78*o*–3, 78q and 78w), by adding §§ 240.11A–1[A] and 240.11A–1[B] to read as follows:

**§ 240.11A–1[A] Public exposure of customer orders.**

(a) *Principal Transactions.* No broker-dealer shall buy (sell) a subject 19c–3 security from (to) a customer for a proprietary account of the member otherwise than on a national securities exchange unless:

(1) The broker-dealer (i) is registered and acting as an ITS/CAES market maker in the subject 19c–3 security; (ii) has access to, and the published bids and offers of such broker-dealer in the subject 19c–3 security can be reached through, the ITS/CAES Interface; and (iii) complies with paragraph (a)(2) of this section or, as an alternative, paragraph (a)(3) of this section is complied with.

(2) The broker-dealer completes the steps set forth in clauses (i)–(iv) of this paragraph:

(i) The broker-dealer must "stop" (*i.e.*, guarantee the execution of) the total number of shares he intends to buy (sell) at his intended purchase price from (sale price to) the customer (hereinafter referred to as the "stop price");

(ii) Subject to the provisions of paragraph (a)(2)(v) of this section, the broker-dealer must publish for at least 60 seconds an offer (bid) on behalf of the customer, in a size equal to the number of shares he intends to buy from (sell to) the customer, at an offer price which is ⅛ higher (bid price ⅛ lower) than the stop price;

(iii) Subject to the provisions of paragraph (a)(2)(v) of this section, the broker-dealer must publish for at least 60 seconds a bid (offer) for his own account, in a size equal to the number of shares he intends to buy from (sell to) the customer, at the stop price;

(iv) After completing the steps required by paragraphs (a)(2) (i), (ii) and (iii) of this section, the broker-dealer may (and under his "stop" must) immediately execute the customer's order (or whatever portion thereof remains unexecuted after publication of an offer (bid) on behalf of the customer in accordances with paragraph (a)(2)(ii) of this section) at the stop price, as principal.

(v) The following shall be applicable to clauses (ii), (iii) and (iv) of this paragraph:

(A) The requirements of paragraph (a)(2)(ii) of this section shall be deemed to be satisfied so long as the offer (bid) otherwise being published by the broker-dealer and maintained for at least 60 seconds, exclusive of any portion thereof which is for a proprietary account of the broker-dealer, meets the price requirement and meets or exceeds the size requirement of paragraph (a)(2)(ii) of this section;

(B) The requirements of paragraph (a)(2)(iii) of this section shall be deemed to be satisfied so long as the bid (offer) otherwise being published by the broker-dealer and maintained for at least 60 seconds includes a bid (offer) for the broker-dealer's own account which meets the price requirement and meets or exceeds the size requirement of paragraph (a)(2)(iii) of this section;

(C) The offer and bid (bid and offer) required to be published and maintained under paragraphs (a)(2) (ii) and (iii) of this section may each be reduced in size to the extent of any partial acceptance by one or more third parties of the customer's offer (bid) required to be published under paragraph (a)(2)(ii) of this section occurring within the 60-second period contemplated by paragraphs (a)(2) (ii) and (iii) of this section; and, apart from any reduction for that reason, the broker-dealer's bid (offer) required to be published and maintained under paragraph (a)(2)(iii) of this section may be reduced in size to the extent of any partial acceptance thereof by one or more third parties occurring within the 60-second period contemplated by paragraph (a)(2)(iii) of this section;

(D) If a bid (offer) for a proprietary account of a broker-dealer required to be published and maintained for 60 seconds under paragraph (a)(2)(iii) of this section has been accepted in whole by one or more third parties, and if the broker-dealer thereafter publishes an offer (bid) which is lower (higher) than

the offer (bid) on behalf of a customer required to be published and maintained for 60 seconds under paragraph (a)(2)(ii) of this section, he shall be deemed to have completed the steps required by paragraphs (a)(2) (ii) and (iii) of this section.

*or*

(3) The customer's order is entered in ITS/CAES without being directed specifically to the broker-dealer for execution and is executed in ITS/CAES under circumstances that preclude (i) all persons responsible for making bids or offers or effecting transactions for the broker-dealer's proprietary account in that security from having any knowledge of the existence of that customer's order prior to its entry in ITS/CAES, and (ii) all persons responsible for the solicitation of customers' orders or for the manner and timing of entry of such orders in that security in ITS/CAES from having any knowledge of positions or trading strategies then existing for the broker-dealer's proprietary account in that security.

(b) *Agency cross transactions.* No broker-dealer shall effect an agency cross transaction involving subject 19c-3 securities unless such transaction is executed on or through the facilities of a national securities exchange or in ITS/CAES.

(c) *Exclusions.* The provisions of this rule shall not apply to:

(1) Any principal transaction or agency cross transaction involving a block;

(2) Any transaction which is part of a primary distribution by an issuer, or a registered or unregistered secondary distribution;

(3) Any transaction made in reliance on Section 4(2) of the Securities Act of 1933;

(4) Any trade at a price unrelated to the current market for the security involved for the purpose of correcting an error or the enable the seller to make a gift;

(5) Any transaction pursuant to a tender offer;

(6) Any purchase or sale effected upon the exercise of an option pursuant to the terms thereof or the exercise of any other right to acquire a security at a pre-established consideration unrelated to the current market for such security;

(7) Any transaction for less than 100 shares; or

(8) Any transaction effected outside of the normal operating hours of the ITS/CASE interface.

(d) *Exemptions.* The Commission may exempt from the provisions of this section, either unconditionally or on specified terms and conditions, any broker, dealer, transaction or class of transactions if the Commission determines that such exemption is consistent with the public interest, the protection of investors and the removal of impediments to, and perfection of the mechanisms of, a national market system.

(e) *Definitions.* For purposes of this rule:

(1) The term "19c-3 security" means any security listed on a national security exchange for which transaction reports are collected, processed and made available pursuant to an effective transaction reporting plan, other than a "covered security" as defined in § 240.19c-3 (Rule 19c-3 under the Act).

(2) The term "effective transaction reporting plan" shall mean any plan approved by the Commission pursuant to § 240.11Aa3-1 (Rule 11As3-1 under the Act) for collecting, processing, and making available transaction reports with respect to transactions in an equity security or class of equity securities;

(3) The term "transaction report" shall mean a report containing the price and volume associated with a completed transaction involving the purchase or sale of a security.

(4) The term "subject 19c-3 security" shall mean any 19c-3 security which is eligible to be traded through the ITS/CAES Interface.

(5) The term "Intermarket Trading System" ("ITS") shall mean the intermarket communications linkage operated jointly by certain self-regulatory organizations pursuant to a plan filed with, and approved by, the Commission pursuant to § 240.11Aa3-2 (Rule 11As3-2 under the Act).

(6) The term "Computer Assisted Execution System" ("CAES") shall mean the computerized order routing and execution system owned and operated by the National Association of Securities Dealers Inc. ("NASD") as part of the NASDAQ inter-dealer quotation system.

(7) The term "ITS/CAES Interface" shall mean the automated interface between the ITS and CAES.

(8) The term "ITS/CAES "means the linked trading systems connected by the ITS/CAES Interface.

(9) The term "ITS market" shall mean, with respect to any subject 19c-3 security, any national securities exchange which is a participant in the ITS Plan and trades such security through ITS and any ITS/CAES market maker in such security.

(10) The term "ITS/CAES market maker" shall mean, with respect to any subject 19c-3 security, any third market maker that is registered as a market maker in such security with the NASD for purposes of use of ITS/CAES.

(11) The term "third market maker" shall mean, with respect to any subject Rule 19c-3 security, any broker-dealer who holds himself out as being willing to buy and sell such security for his own account on a regular and continuous basis otherwise than on a national securities exchange in amounts of less than block size (including any such person who also represents as agent, orders to buy and sell such security on behalf of any other person and communicates bids and offers to a national securities association pursuant to § 240.11Ac1-1 (Rule 11Ac1-1 under the Act) on behalf of such other persons as well as for his own account).

(12) The term "broker-dealer" shall mean any brokers or dealers.

(13) The term "customer" of a broker-dealer shall mean (i) any person other than a broker or dealer, except that the term "customer" shall include a broker or dealer (A) which, directly or indirectly, controls, is controlled by or is under common control with the broker-dealer, or (B) whose customers' accounts are introduced to the broker-dealer and are carried by it on either a disclosed or undisclosed basis; and (ii) any person from whom an order has been accepted by the broker-dealer for execution as agent, but only with respect to orders so accepted.

(14) The term "proprietary account" shall mean any one or more accounts in which the broker-dealer has a direct or indirect interest.

(15) A bid or offer shall be "published" when it is made available by a national securities association to a quotation vendor pursuant to § 240.11Ac1-1 (Rule 11Ac1-1 under the Act) and is displayed in CAES.

(16) The term "intended purchase price from (sale price to) the customer" in a principal transaction shall exclude any commission, commission equivalent, differential or comparable charge to be imposed by the broker-dealer in connection with the transaction.

(17) The term "block" shall mean a transaction of 10,000 shares or more or involving a quantity of stock having a market value or $200,000 or more.

(18) For purposes of this rule, a riskless principal transaction shall be considered to involve a purchase from or sale to a customer.

**§ 240.11A-1[B] Public exposure of customer orders.**

(a) *Principal Transactions.* No broker-dealer shall buy (sell) a subject Rule

19c–3 security from (to) a customer for a proprietary account of the broker-dealer unless:

(1) The broker dealer (i) is registered and acting as an exchange market maker or ITS/CAES market maker in the subject Rule 19c–3 security; (ii) has access to, and the published bids and offers of such broker-dealer in the subject Rule 19c–3 security can be reached through, the ITS/CAES Interface; and (iii) complies with paragraph (a)(2) of this section, or as an alternative, paragraph (a)(3) of this section is complied with.

(2) The broker-dealer completes the steps set forth in clauses (i)–(iii) of this paragraph:

(i) The broker-dealer must "stop" (*i.e.*, guarantee the execution of) the total number of shares he intends to buy (sell) at his intended purchase price from (sale price to) the customer (hereinafter referred to as the "stop price");

(ii) Subject to the provisions of paragraph (a)(2)(iv) of this section, the broker-dealer must publish for at least 60 seconds an offer (bid) on behalf of the customer, in a size equal to the total number of shares he intends to buy from (sell to) the customer, at an offer price which is ⅛ higher (bid price ⅛ lower) than the stop price;

(iii) After completing the steps required by paragraphs (a)(2) (i) and (ii) of this section, the broker-dealer may (and under his "stop" must) immediately execute the customer's order (or whatever portion thereof remains unexecuted after publication of an offer (bid) on behalf of the customer in accordance with paragraph (a)(2)(ii)) of this section at the stop price, as principal;

(iv) (A) The requirements of paragraph (a)(2)(ii) of this section shall be deemed to be satisfied so long as the offer (bid) otherwise being published by the broker-dealer and maintained for at least 60 seconds from the time the order is received for execution meets the price requirement and meets or exceeds the size requirement of paragraph (a)(2)(ii) of this section; *Provided, however,* that in the event a portion of such offer (bid) is for a proprietary account of the broker-dealer, the customer's order shall be deemed to be substituted for the broker-dealer's offer (bid) up to the lesser of the size of the order or the broker-dealer's proprietary interest and any executions during such 60-second period at the offer price (bid price) which, in the aggregate, are less than or equal to the size of the customer's order shall be for the account of the customer.

(B) Any offer (bid) required to be published and maintained under paragraph (a)(2)(ii) of this section may be reduced in size to the extent of any partial acceptance by one or more third parties of the offer (bid) occurring during the 60-second period contemplated by that clause.

(C) If the broker-dealer, during the 60-second period contemplated by paragraph (a)(2)(ii) of this section, lowers (raises) his offer (bid) to the stop price, that broker-dealer shall, pursuant to his "stop," immediately execute the customer's order (or whatever portion thereof remains unexecuted) at the stop price, as principal.

*or*

(3) The customer's order is entered in ITS/CAES on a neutral basis (*i.e.*, otherwise than by directing the order to the broker-dealer for execution) and is executed in ITS/CAES under circumstances that preclude (i) all persons responsible for making bids and offers or effecting transactions for the broker-dealer's proprietary account in that security from having any knowledge of the existence of that customer's order prior to its entry in ITS/CAES, and (ii) all persons responsible for the solicitation of customers' orders or for the manner and timing of entry of such orders in that security in ITS/CAES from having knowledge of positions or trading strategies then existing for the broker-dealer's proprietary account in that security.

(b) *Agency cross transactions.* No broker-dealer shall effect an agency cross transaction involving a subject Rule 19c–3 security unless such transaction is executed on or through the facilities of a national securities exchange or in ITS/CAES; *Provided, however,* That a broker-dealer may effect an agency cross transaction otherwise than on or through the facilities of a national securities exchange or in ITS/CAES (i) at a price higher than the best bid and lower than the best offer for the subject 19c–3 security then being disseminated by any ITS market(s) (if the spread between such best bid and best offer is ¼ or more); or (ii) at a price equal to the best bid or best offer for the subject 19c–3 security then being disseminated by any ITS market(s) (if the spread between such best bid and best offer is ⅛).

(c) *Exclusions.* The provisions of this section shall not apply to:

(1) Any broker-dealer, other than an exchange market maker, with respect to transactions on or through the facilities of a national securities exchange;

(2) A principal transaction or agency cross transaction involving a block of a subject Rule 19c–3 security;

(3) Any transaction which is part of a primary distribution by an issuer, or a registered or unregistered secondary distribution;

(4) Any transaction made in reliance on Section 4(2) of the Securities Act of 1933;

(5) Any trade at a price unrelated to the current market for the suject Rule 19c–3 security involved for the purpose of correcting an error or to enable the seller to make a gift;

(6) Any transaction pursuant to tender offer;

(7) Any purchase or sale of a subject Rule 19c–3 security effected upon the exercise of an option pursuant to the terms thereof or the exercise of any other right to acquire a subject Rule 19c–3 security at a pre-established consideration unrelated to the current market for such security;

(8) Any transaction in any subject security for less than 100 shares;

(9) Any transaction effected outside of normal operating hours of the ITS/CAES interface; and

(10) Any principal transaction effected on or through the facilities of a national securities exchange during any period when such exchange is relieved of its obligation to collect, process and make available to quotation vendors bids and offers in such security pursuant to paragraph (b)(3)(i) of § 240.11Ac1–1 (Rule 11c1–1 under the Act).

(d) *Exemptions.* The Commission may exempt from the provisions of this section, either unconditionally or on specified terms and conditions, any broker, dealer, transaction or class of transactions if the Commission determines that such exemption is consistent with the public interest, the protection of investors and the removal of impediments to, and perfection of the mechanisms of, a national market system.

(e) *Definitions.* For purposes of this section, (1) The term "Rule 19c–3 security" shall mean any security listed on a national securities exchange for which transaction reports are collected, processed and made available pursuant to an effective transaction reporting plan, other than a "covered security" as defined in § 240.19c–3 (Rule 19c–3 under the Act).

(2) The term "effective transaction reporting plan" shall mean any plan approved by the Commission pursuant to § 240.11Aa3–1 (Rule 11Aa3–1 under the Act) for collecting, processing and making available transaction reports with respect to transactions in an equity security of class, of equity securities.

(3) The term "transaction report" shall mean a report containing the price

volume associated with a completed transaction involving the purchase or sale of a security.

(4) The term "subject Rule 19c–3 security" shall mean any Rule 19c–3 security which is eligible to be traded through the ITS/CAES Interface.

(5) The term "Intermarket Trading System" ("ITS") shall mean the intermarket communications linkage operated jointly by certain self-regulatory organization pursuant to a plan filed with, and approved by, the Commission pursuant to § 240.11Aa3–2 (Rule 11Aa3–2 under the Act).

(6) The term "Computer Assisted Execution System" ("CAES") shall mean the computerized order routing and execution system owned and operated by the National Association of Securities Dealers ("NASD") as part of the NASDAQ inter-dealer quotation system.

(7) The term "ITS/CAES interface" shall mean the automated interface between the ITS and CAES.

(8) The term "ITS/CAES" shall mean the linked trading systems connected by the ITS/CAES Interface.

(9) The term "ITS market" shall mean, with respect to any subject Rule 19c–3 security, any national securities exchange which is a participant in the ITS and trades such security through ITS and amy ITS/CAES market maker in such security.

(10) The term "exchange market maker" shall mean, with respect to any subject Rule 19c–3 security traded on a national securities exchange, any broker-dealer registered or approved as a specialist or market maker in that security pursuant to the rules of such exchange.

(11) The term "ITS/CAES market maker" shall mean, with respect to any subject Rule 19c–3 security, any third market maker that is registered as a market maker in such security with the NASD for purposes of use of ITS/CAES.

(12) The term "third market maker" shall mean, with respect to any subject Rule 19c–3 security, any broker-dealer who holds himself out as being willing to buy and sell such security for his own account on a regular and continuous basis otherwise than on a national securities exchange in amounts of less than block size (including any such person who also represents, as agent, orders to buy and sell such security on behalf of any other person and communicates bids and offers to a national securities association pursuant to § 240.11Ac1–1 (Rule 11Ac1–1 under the Act) on behalf of such other persons as well as for his own account).

(13) The term "broker-dealer" shall mean any broker or dealer.

(14) The term "customer" of a broker-dealer shall mean (i) any person other than a broker or dealer, except that the term "customer" shall include a broker or dealer (A) which, directly or indirectly, controls, is controlled by, or is under common control with such broker-dealer, or (B) whose customers' accounts are introduced to the broker-dealer and are carried by it on either a disclosed or undisclosed basis; and (ii) and person from whom an order has been accepted by the broker-dealer for execution, but only with respect to orders so accepted.

(15) The term "proprietary account" shall mean any one or more accounts in which the broker-dealer has a direct or indirect interest.

(16) A bid or offer shall be "published" when it is made available by a national securities exchange or national securities association to a quotation vendor pursuant to § 240.11Ac1–1 (Rule 11Ac1–1 under the Act) and is displayed on or through the facilities of such exchange or in CAES (as the case may be).

(17) The term "intended purchase price from (sale to) the customer" in a principal transaction shall exclude any commission, commission equivalent, differential or comparable charge to be imposed by the broker-dealer in connection with the transaction.

(18) The term "block" shall mean a transaction of 10,000 shares or more or involving a quantity of a subject Rule 19c–3 security having a market value of $200,000 or more.

(19) For purposes of this rule, a riskless principal transaction shall be considered to involve a purchase from or sale to a customer.

By the Commission.

Dated: May 13, 1982.

**George A. Fitzsimmons,**

*Secretary.*

[FR Doc. 82-14024 Filed 5-21-82; 8:45 am]

BILLING CODE 8010-01-M

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

### 26 CFR Part 1

**[LR–313–81]**

## Exempt Royalty Oil; Public Hearing on Proposed Regulations

**AGENCY:** Internal Revenue Service, Treasury.

**ACTION:** Notice of public hearing on proposed regulations.

**SUMMARY:** This document provides notice of a public hearing on proposed regulations relating to exempt royalty oil.

**DATES:** The public hearing will be held on July 13, 1982, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by June 29, 1982.

**ADDRESS:** The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR–313–81), Washington, D.C. 20224.

**FOR FURTHER INFORMATION CONTACT:** Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service; 1111 Constitution Avenue, NW., Washington, D.C. 20224, 202–566–3935, not a toll-free call.

**SUPPLEMENTARY INFORMATION:** The subject of the public hearing is proposed regulations under sections 4994, 4995 and 4997 of the Internal Revenue Code of 1954. The proposed regulations appeared in the **Federal Register** for Wednesday, March 3, 1982 (47 FR 9018).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by June 29, 1982. Each speaker will be limited to 10 minutes for oral presentation exclusive of time consumed by questions from the panel for the government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive for improving government regulations appearing in the **Federal Register** for Wednesday, November 8, 1978.